Monday, December 31, 2001

Weekly Electricity Status Report

1. Northwest Power Pool Status (WA, OR, ID, MT, WY, UT, No. NV, BC, AB)

- Power Pool peak load (Friday, 12/21): 48,563 MW
- Reserve margins were within comfortable ranges for Northwest Power Pool utilities.

2. Mid-Columbia Trading Hub Electricity Prices

- Weekly Range at Mid-C: $22.5-33 per MWh
- "Normal" price range, before 5/00 $20-$40 per MWh

3. California Electricity Situation

- CA ISO Alert Status
  - There were no warning notices this week.
  - Most recent rotating blackouts: Tuesday, May 8

- News Headlines from California
  - Audit finds power pact ill conceived (LA Times Dec. 21)
  - Warmer climate could disrupt water supplies (Env. News Service, Dec. 20)

- Status of Emergency Orders
  - Federal court has ruled that generators can't be forced to sell emergency power to the state in suit brought by Reliant. (Updated April 9)

4. River and Snowpack Information (updated 12/26)

- Observed November Streamflows: 86% of average at The Dalles
- Snowpack: N/A

5. Energy Conservation Achievement (updated 12/17)

- **Major electric utilities:** 3-12% below normal; Tacoma 12% total savings since Jan 1. (Updated June 5)
- **State Agencies:** From January 2001 – September 2001 the monthly average savings has been -10.13% for electricity and –14.73% for natural gas. (Updated December 17)

6. Fish/Reservoir Impacts (updated 12/10)

- Operations to protect Columbia River chum salmon spawning below Bonneville Dam began on Nov. 20. The target for chum flows below Bonneville Dam is a tailwater elevation of 11.0 feet, which takes tidal and tributary influences into account.

7. Power Exchanged with California (updated 12/17)

- Week of Dec 6-12
  - Power sent to CA ISO: 0 MWh
  - Power returned from CA ISO: 0 MWh
  - Amount CA ISO owes BPA: 0 MWh

CA ISO has now returned all power owed to BPA as a result of exchanges entered into during the winter and spring of 2001. No further exchanges are anticipated at this time.

THE STATE

Audit Finds Power Pacts Ill-Conceived, Rushed

■Finances: Most thorough report yet on state's long-term purchases says poor analysis of energy needs led to high costs, other problems.

By NANCY VOGEL, TIMES STAFF WRITER

SACRAMENTO -- Desperate to avoid blackouts last spring, the state moved too fast to sign long-term power contracts that are ill-matched to California's needs, according to the most comprehensive audit yet of California's 11 months in the power-buying business.

A report released Thursday by the Bureau of State Audits concludes that the Department of Water Resources, thrust in January into the emergency role of buying power for 27 million utility customers, should have done a better analysis of power needs before it signed 57 separate agreements with energy companies.

The water resources department signed those deals to avoid record high prices in a deregulated market gone haywire. "Decisions committing the customers of the investor-owned utilities to $35.9 billion in future power-purchase obligations were made in 30 days," auditors wrote. Several billion dollars in additional contracts were negotiated later in the year.

Auditors also criticize the department for failing to include enforcement provisions, standard in the power industry, in case sellers don't deliver electricity as promised under the contracts.

And they warn that the state must monitor the contracts over the next decade to make sure they don't end up costing the customers of Southern California Edison, Pacific Gas & Electric and San Diego Gas & Electric more than necessary. Some of the contracts force the state to pick up such costs as air pollution fees for power plants.

Portfolio Holds 'Significant Risks'

"The speed in which the department entered into contracts in response to the crisis precluded the planning necessary for a power-purchasing program of this size," the auditors said. "As a result, it assembled a portfolio of power contracts that presents significant risks that will need careful management to avoid increased costs to consumers."

The state auditor's report echoes the criticisms that consumer advocates, environmentalists and lawmakers have leveled against the Department of Water Resources contracts for months.

"It's what we've been saying all along," said Sen. John Burton, (D-San Francisco). "Too much, too fast and a lot of the wrong kind."

Critics say the contracts will strap Californians with high electricity rates for a decade. The average price of power in the contracts is $70 per megawatt-hour, while power can be bought on the spot market now for $30 per megawatt-hour or less. A megawatt-hour is enough electricity to supply 750 homes for an hour.

But Water Resources officials say Californians couldn't have had those current low prices without the large contracts. The fact that the state signed the contracts tamed the power market, they say.

The amount that the department spends each month buying power has plunged 80% since May. No blackouts were triggered last summer, despite dire predictions. And supporters of the contracts say the long-term agreements help guarantee that major new power plants will soon be churning out electricity.

"You can't win; you cannot satisfy everyone," said Oscar Hidalgo, spokesman for the 135-person power-buying team at the Department of Water Resources. "The lights are on; the costs are way down; stability is back in the market. The long-term contracts are a big part of it."

After months of defending the long-term contracts, aides to Gov. Gray Davis have begun trying to renegotiate some to get better terms for the state.

The original negotiations were led by S. David Freeman, the former general manager of the Los Angeles Department of Water and Power and current head of the state's 4-month-old public power authority. At the time, Davis pushed Freeman hard to get the contracts, which normally would take months to negotiate, finished in weeks. On Thursday, Freeman declined to comment on the audit, referring inquiries to Department of Water Resources.

Experienced at buying and selling electricity as a sideline to running the pumps of the State Water Project, the department was tapped by Davis on Jan. 17 to begin buying roughly 30% of the electricity needed by the customers of Edison, PG&E and San Diego Gas & Electric.

The utilities had been drained of cash by seven months of soaring wholesale electricity prices. Power plant owners and electricity marketers no longer wanted to do business with the utilities for fear of not getting paid. Fearing widespread blackouts, Davis signed a bill into law authorizing the state to use its good credit rating and taxpayer funds to keep power flowing to Edison, PG&E and SDG&E customers.

The law that makes the Department of Water Resources the biggest electricity buyer in the West expires at the end of next year, when the utilities presumably will be financially healthy enough to take back the job of buying power.

Oversight of Contracts Unclear

It's not clear whether the department, the utilities or perhaps the new state power authority will take over management of the contracts after 2002, said department Director Tom Hannigan.

While acknowledging the immense challenge the Department of Water Resources faced in January, state auditors say the department should have moved more methodically. Too many of the contracts commit the state to buying electricity six days a week, 16 hours a day, they say. As a result, at times of low demand, the state must sell power at a loss.

The department's own calculations show that such surplus sales could cost consumers as much as $4 billion over the next nine years.

In the opposite scenario, on hot summer days when air conditioning drives electricity consumption to peak levels, California may find itself vulnerable to price spikes because the long-term contracts don't include enough commitments from "peaker" plants, which are designed to run briefly.

Auditors also say that most contracts leave the department vulnerable if a power seller fails to deliver under the contract and instead sells the power for a higher price in the spot market. Many of the contracts limit the state in such a situation to recovering the difference between the contract price and the cost to replace the power.

"A better remedy would have been the right to terminate contracts with generators that repeatedly fail to deliver," auditors wrote.

WARMER CLIMATE COULD DISRUPT WATER SUPPLIES

BOULDER, Colorado, December 20, 2001 (ENS) - Just one or two degrees of global warming could have dramatic impacts on water resources across western North America, a new study suggests.

Teams who have modeled the climate in the area are warning of reduced snow packs and more intense flooding as temperatures rise.

The research marks the first time that global climate modelers have worked with teams running detailed regional models of snowfall, rain and stream flows to predict what warming will do to the area. The researchers, from the National Center for Atmospheric Research and elsewhere, were surprised by the size of the effect generated by only a small rise in temperature.

Assuming current levels of pollution emissions, greenhouse gases will warm the west coast of North America by just one or two degrees Celsius over the next century, and average precipitation will not change much. But in the model, warmer winters raised the snowline, reducing mountain snow packs, the researchers told the American Geophysical Union in San Francisco last week.

"We realized that huge areas of the snow pack in the Sierra went down to 15 per cent of today's values," said Michael Dettinger, a research hydrologist at the Scripps Institution of Oceanography in La Jolla, California. "That caught everyone's attention."

The researchers also predict that by the middle of the century, melting snow will cause streams to reach their annual peak flow up to a month earlier. With warm rains melting snow or drenching already saturated ground, the risk of extreme floods will rise.

"We have to believe in these very warm, very wet storms," said Andrew Wood, a water resources modeler at the University of Washington in Seattle.

Since dams cannot be filled until the risk of flooding is past, the models predict they will trap just 70 to 85 percent as much runoff as they do now. This is a particular problem for California, where agriculture, industry, a burgeoning population and environmental needs already clash over limited water supplies.

Observations back up the models. Minton points out that an increasing percentage of California's precipitation over recent decades is falling as rain rather than snow.

Iris Stewart, a climate researcher at the University of California, San Diego, has found that in the last 50 years, runoff peaks in the western U.S. and Canada have been happening earlier and earlier. The cause seems to be a region wide trend towards warmer winters and springs.

From a December 22 article in the British journal "New Scientist"

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- News Headlines from California
  - Enron is a cancer on the presidency (LA Times Jan. 02)
  - BPA News Shorts
  - Bright Lights Cannot Hide Energy Woes

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Robert Scheer, Los Angeles Times

Enron Is a Cancer on the Presidency

Finally, a reporter had the temerity to question Bush on Friday regarding the ignominious collapse of Enron Corp. run by Kenneth L. Lay, a Bush family intimate and top campaign contributor. Bush expressed concern "for the citizens of Houston who worked for Enron who lost life savings" and added: "It's very important for us to fully understand the 'whys' of Enron."

Sure is, but did Bush never ask "Kenny Boy"--his nickname for Enron's chairman--what was going on?

After all, not only was Kenny Boy one of Bush's major contributors, but it was Lay and Enron that Bush turned to for critical advice on how to further exploit U.S. natural resources. The media, which had hounded Bill Clinton on his Whitewater connections, have allowed Bush to maintain the fiction that his--and his father's--administration had nothing to do with the debacle that is Enron.

Given the intense interest in the list of those who slept over in the Clinton White House, it's odd that no attention has been paid to Kenny Boy's sleepover in the early years of the senior Bush's White House.

Those early Bush years were crucial for Enron, beginning with the passage of the 1992 Energy Policy Act, which forced the established utility companies to carry Enron's electricity sales on their wires.

At the same time, Wendy Gramm, who served under the elder Bush as chair of the Commodity Futures Trading Commission, allowed for an exemption in the trading of energy derivatives, which, as the Washington Post reported, "later became Enron's most lucrative business."

Once that was accomplished, Gramm, wife of Texas GOP Sen. Phil Gramm, resigned from her government post to take a position on the Enron board. As one of the members of the board's audit committee, she now is expected to be a key figure in the lawsuits and federal investigation revolving around Enron's collapse. Recently, the chief executive of Arthur Andersen, Enron's outside auditor, told a congressional committee that the accounting firm had warned the Enron audit committee of what he termed "possible illegal acts within the company."

Wendy Gramm is also mentioned in a bank lawsuit alleging insider trading as having sold $276,912 in Enron stock in November 1998. Her response is that she sold the stock to avoid the appearance of a conflict of interest, given that her husband was chairman of the Senate Banking Committee.

Yet she was still very much on the Enron board and being rewarded with future stock options when her husband last year pushed through legislation that exempted key elements of Enron's energy business from oversight by the federal government. Phil Gramm had obtained $97,350 in political contributions from Enron over the years, so perhaps he was acting on his own instincts and not his wife's urgings. The exemption was passed over the objection of the Clinton administration.

Wendy Gramm also directs the regulatory studies program at George Mason University, which has received $50,000 from Enron since 1996. Her academic institute is highly influential in arguing for deregulation, conveniently joining her corporate and academic interests.

Unfortunately for true-believer deregulators, the Enron collapse shreds their panacea. Surely no one, least of all Wendy Gramm, who has said she was kept unaware of the company's chicanery in hiding debt and conducting secret private deals to the detriment of stockholders, could argue today with a straight face that Enron was in need of less government oversight.

The fact is that there would be no Enron as we know it were it not for Republican-engineered changes in government regulation that permitted Enron its meteoric growth.

It's true that the corporation had its allies among the Democrats; campaign finance corruption and influence peddling are generally a cover-all-your-bets bipartisan activity. But in this case, the amounts given to Democrats were puny and late, and there's no doubt that Enron rode to power primarily on the strength of Lay's influence with the Bush family. This fact is not mitigated by Enron now hiring Clinton's former lawyer and various top Democratic lobbying groups, except to note that these hired guns have no shame.

The Bush family ties to Kenny Boy Lay are just too intimate and lucrative to ignore.

There also are at least four Enron consultants and executives who hold high positions within the Bush White House, and some of them may be drawn into the investigations that cannot be avoided, despite the distractions of the war on terror.

As John Dean once famously said of the Nixon administration, there is a cancer growing on the presidency, but in this case it's name is Enron, and it won't go away by being ignored.

BPA DOUBLES WIND ENERGY PURCHASES

BPA is doubling the amount of electricity bought from wind generation projects. In an agreement signed Thursday, BPA will purchase about 34 percent of the output from the Stateline Wind Project located on the Oregon-Washington border southwest of Walla Walla, Wash. About 90 megawatts of power will be delivered to BPA through PacifiCorp Power Marketing Inc., a subsidiary of ScottishPower, beginning Dec. 29, 2001 and extending for 25 years. BPA's purchase can provide energy for about 18,000 homes. The contract is the largest single wind energy purchase for the agency so far.

The Stateline project is built, owned and operated by FPL Energy, LLC. When the first phase is completed, 399 wind turbines will be arranged in several strings on privately owned hilltops and ridges west of Walla Walla, Wash., and north of Pendleton, Ore. near the Columbia River bend. Each machine can generate 660 kilowatts. The entire project can produce 265 megawatts, all of which is marketed by PacifiCorp Power Marketing.

BPA currently purchases 34 megawatts of wind power from Foote Creek located in Wyoming, and recently announced a 50-megawatt purchase from another wind power development in Condon, Ore. And there are six more wind projects at the top of the priority list and under evaluation that could add over 600 additional megawatts to BPA's supply of wind generated power for the Northwest.

http://www.latimes.com/news/local/politics/cal/la-000101997dec25.story?coll=la%2Dnews%2Dpolitics%2Dcalifornia

NEWS ANALYSIS

Bright Lights Cannot Hide Energy Woes

Power: An abundant supply has eased fears of blackouts. However, many problems persist, with no common vision and a lack of urgency from lawmakers.

By NANCY VOGEL
TIMES STAFF WRITER

December 25 2001

SACRAMENTO -- It was a year ago this month that the meltdown of California's deregulated energy market hit crisis stage. Gov. Gray Davis plugged in the official state Christmas tree last December, then had it turned off 30 minutes later as a message to Californians to go easy on the strained electricity grid.

"Tonight while some Californians are going without power," the governor said at the time, "let the light in our hearts represent the true spirit of the season."

This year, when Davis powered up the thousands of bulbs on the capitol Christmas tree he let them glow until 10 p.m. One year after a crisis of high prices crippled the state's utilities and destroyed its dream of creating the most comprehensive, deregulated power market in the nation, California has a jury-rigged, temporarily stable electricity industry and a financial hangover.

But political leaders don't have a plan for the industry's ultimate shape. Various branches of government are trying to fix assorted problems, with no common vision.

"We don't have a market right now; we don't have a structure that is viable going forward," said Severin Borenstein, director of the University of California Energy Institute in Berkeley. "We have to figure out, are we going to try to reregulate the whole system? Are we going to have a working deregulated system? Right now we're not doing anything. We're adrift, and the Legislature has turned its attention elsewhere because it isn't a day-to-day crisis."

There's no desperate call for conservation now, no midafternoon warnings of blackouts. Power is downright abundant--sometimes even surplus--and as low-priced as it was before the crisis.

But so much is reordered. The electricity market is dead, and its antithesis, a government-controlled power agency with vague duties, has been born. The biggest private utility in the state, Pacific Gas & Electric, is in bankruptcy, and so is the world's largest electricity marketer: Enron Corp. California's Department of Water Resources, once a minor player in the electricity business, now dominates the Western transmission grid.

The state has eaten a $6.1-billion hole in its budget buying electricity. It has utility rates that are up to 46% higher than a year ago and a passel of long-term power contracts that critics call too expensive.

Experts tick off a litany of knotty policy problems--some of which helped destroy California's experiment with deregulation--that remain unresolved.

They say the rules under which the California Independent System Operator buys electricity must be overhauled. California has yet to resolve whether businesses and homeowners should be allowed to buy power from companies other than their designated utility. There's no plan for how long the state, bankrolled by taxpayer money, should stay in the power-buying business. The transmission grid needs to be expanded. The Davis administration is trying to renegotiate some of its long-term power contracts. And PG&E is in Bankruptcy Court seeking to shift its assets out from under state regulation.

With little input from Davis or the Legislature, the job of making stopgap fixes--some with long-term consequences--has fallen to the Public Utilities Commission, the Department of Water Resources and Cal-ISO, the agency born of the state's 1996 deregulation plan.

"All the PUC is doing is putting pieces into the puzzle," said PUC President Loretta M. Lynch. "How big the puzzle is and what the shape of it is still lies in the bailiwick of the Legislature and the governor."

"Whether our energy system looks like a camel or an elephant is not up to the PUC," Lynch said.

Senate Leader John Burton (D-San Francisco) said lawmakers can't be expected to lead the way.

"The people that are experts in this--i.e. the PUC, i.e. Cal-ISO, i.e. the Energy Commission--if they've got solutions, they should bring them to us," he said.

"The Legislature deals with a host of things from education to public safety to highways to agriculture to natural resources," Burton said. "The legislators are not experts in energy."

Davis does have a vision for the state's industry, said the governor's spokesman Steve Maviglio: "Bring more power on line, keep the conservation momentum and restore the utilities' health."

Paramount, Maviglio said, is getting enough new power plants built by 2004 to give the state a 15% reserve in its electricity supply.

But even achieving that goal wouldn't make a host of other financial, legal and technical troubles go away, experts say. And with electricity prices relatively low, blackouts a distant threat and a November election on the horizon, there's less political will than before to deal with tough energy questions.

'There's Enough Blame to Go Around'

"It's poison politically," said Matt Freedman, an attorney with the Utility Reform Network, a consumer group in San Francisco. "Everybody knows the energy crisis was mishandled. There are different views as to how. But there's enough blame to go around, and nobody comes out of this looking good."

Ray Hart, who spent seven months in the center of the electricity maelstrom as a deputy director for the Department of Water Resources, said his experience has convinced him that the way Cal-ISO buys power makes California vulnerable to price spikes. But high-level officials are not looking at such root troubles, he said.

"There's been an absolute lack of a fruitful discussion of how we're going to fix everything that's been broken that caused us to get to where we're at," said Hart, who oversaw the state's emergency power-buying operations from January to August. "Nobody's looking at the future. It's very disturbing."

When Cal-ISO buys electricity to balance the transmission grid, the agency pays all sellers--regardless of what they offered--the price of the highest bid accepted.

Last winter, energy companies exploited Cal-ISO's market. Rather than offer to sell their power a day or more in advance in the state's main electricity market, companies waited until Cal-ISO grid operators desperately needed last-minute power. By waiting, they sometimes collected as much as $750 per megawatt-hour. Such high prices helped to bleed the utilities of cash, pushing them toward bankruptcy.

When the water resources agency took over the buying of electricity on behalf of the utilities in January, Hart said, it tried to save money by steering last-minute power purchases to out-of-state generators. Under Cal-ISO market rules, those generators, such as British Columbia's public utility, get whatever price they bid.

But the owners of California power plants, such as Houston-based Reliant Energy, protested the water resources agency's practice. Last month, federal regulators ruled in their favor. As a result, Cal-ISO last week took back its job of buying all of the last-minute electricity needed to balance the transmission grid. Hart said he fears that prices of such power will jump again.

"It's really easy to all of a sudden realize, hey, I can make more money in the real-time market than in the hour-ahead or day-ahead market, withdraw the energy and wait," Hart said. "They did it. And they're doing it again, as far as I can tell. They're gearing up to game the system."

'Direct Access' Remains Sticky Issue

Cal-ISO officials recently launched an effort to make structural reforms before a federally imposed price cap is lifted in September. An order issued Wednesday by the Federal Energy Regulatory Commission also requires Cal-ISO to set up a market for buying and selling electricity a day or more in advance. California once had such a market, the keystone of its deregulation plan, but it collapsed in January.

"It is the missing piece of the puzzle," said Gregg Fishman, Cal-ISO spokesman.

One of the stickiest issues still gumming up California's electricity works is called "direct access." It is the ability of utility customers, from steel mills to homeowners, to buy electricity from a company other than the utility designated to serve them. Also called retail choice, it was a key goal of the state's original 1996 deregulation plan.

But retail choice never blossomed in California as intended. And when the market began to melt down in January and the state intervened in a drastic way, the Legislature banned customers from leaving utilities. The rationale was that allowing some customers to cut their own energy deals would stick every other customer with a greater share of the state's power bill.

Many businesses took advantage of uncertainty in the law banning direct deals with energy companies. Today, customers who account for more than 10% of the total electricity used in PG&E, Edison and San Diego Gas & Electric territory have cut deals for electricity outside the utilities. The PUC is expected to vote early in the new year to ban such deals retroactively to July.

Big businesses say they'll be hurt--possibly costing California jobs--if they don't get the freedom to shop for cheaper electricity. But consumer advocates fear that homeowners will get stuck paying for most of the $43 billion in long-term power contracts the state has signed if big industrial utility customers are allowed to abandon PG&E, Edison and SDG&E.

Experts say there's a way to share the cost of the contracts and still allow retail choice. Businesses could be forced to pay a tax, such as a penny per kilowatt-hour, to cover their share of the contracted power. Or, they could pay the state a lump sum for the right to leave the utilities.

Who'll Pay? Residents or Big Business?

That's a tricky political calculus that risks offending big employers or millions of homeowners. Lawmakers last summer debated how to find a fair way to allow businesses to leave the utilities, but they disbanded before passing any bills.

"Right now we're leaving it to the PUC to make default judgments that are really misguided," Borenstein said. "They're doing it in a policy analysis vacuum because the Legislature has moved on."

Tuesday January 22, 2002

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- Power Pool peak load (Friday, 1/19): MW 49,137
- Reserve margins were within comfortable ranges for Northwest Power Pool utilities.

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- Weekly Range at Mid-C: $18.5-23 per MWh
- "Normal" price range, before 5/00 $20-$40 per MWh

3. California Electricity Situation

- CA ISO Alert Status
  - There were no warning notices this week.
  - Most recent rotating blackouts: Tuesday, May 8

- News Headlines from California
  - Memo warned of Enron's setup being seen as a hoax (LA Times, 1/16)
  - Andersen knew of Enron risks last February. (LA Times, 1/18)
  - Andersen fires executive who oversaw Enron audit. (LA Times, 1/18)

- Status of Emergency Orders
  - Federal court has ruled that generators can't be forced to sell emergency power to the state in suit brought by Reliant. (Updated April 9)

4. River and Snowpack Information (updated 12/26 & 1/14)

- Observed November stream flows: 90.8% of average at The Dalles
- Snowpack: Forecast 102% of normal (Natl. River Forecast Center)

5. Energy Conservation Achievement (updated 1/14/2002)

- **Major electric utilities:** 3-12% below normal; Tacoma 12% total savings since Jan 1. (Updated June 5)
- **State Agencies:** From January 2001 – November 2001 the monthly average savings has been -10.4% for electricity and –15.5% for natural gas. (Updated January 14, 2002)

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- Operations to protect Columbia River chum salmon spawning below Bonneville Dam began on Nov. 20. The target for chum flows below Bonneville Dam is a tailwater elevation of 11.0 feet, which takes tidal and tributary influences into account.

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  - Amount CA ISO owes BPA: 0 MWh

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Memo Warned of Enron's Setup Being Seen as 'Hoax'

▪Probe: Full text suggests that a senior executive was not telling Kenneth Lay anything new. She ridicules accounting procedures and forecasts the company's collapse.

By MICHAEL A. HILTZIK and DAVID STREITFELD, Times Staff Writers

HOUSTON -- A detailed road map of Enron Corp.'s aggressive accounting maneuvers and an uncannily accurate prediction of the company's collapse were laid before Enron Chairman Kenneth L. Lay in August in a lengthy memo that became public Tuesday.

Excerpts of the memo had been released by congressional investigators Monday, but the full extent of the warnings became known only Tuesday with the release of the entire text.

The author of the memo, Sherron Watkins, 42, expressed concern that the company's vaunted business success would eventually become considered "nothing but an elaborate accounting hoax." Watkins, a vice president of corporate development at Enron, worked directly under the architect of Enron's complex and highly questionable financial dealings.

Watkins focused particularly on what were known as the "Raptor" transactions, in which Enron transferred several marginal investments to a putatively independent partnership. The partnership had gone virtually bankrupt by last summer, but Enron still was not disclosing the loss to shareholders, Watkins said.

The full text suggests that Watkins did not believe she was telling Lay much that he did not already know--and that many of the company's financial transactions were mere accounting shams.

She attempted to persuade Lay either to reverse the offending transactions promptly or to disclose them fully to shareholders and "develop damage containment plans." Lay did neither.

"Her motivation is not vindication or being proven right or bringing down the company," her husband, Richard, said Tuesday from the family home in Houston. "She's a team player."

Watkins went to work at Enron Tuesday morning as news of her memo was splashed across the front pages.

"It's a normal day," said her lawyer, Philip Hilder, although he acknowledged that "it's very difficult for anybody to go to work under these circumstances."

Watkins has suffered no retaliation from anyone at the company, the lawyer said, although a source close to her said Watkins has been made to feel "an outcast."

Sherron Watkins, the daughter of two secondary school educators, grew up in the distant Houston suburb of Tomball and graduated from the University of Texas.
Tuesday morning, television news trucks jammed the street in front of the Watkins home. Later that day, Richard Watkins praised his wife for doing "something quite courageous. She has the strength of her convictions. But she's very vulnerable."

A neighbor said the hint of moral indignation in Watkins' memo to Lay was genuine.

"Clearly she thought it was her moral and professional duty to do what she did," said Carrie Wood, who also was Watkins' sorority sister at UT. "Sherron was drawn to the dynamic intellectual challenge of being an Enron vice president. I don't think she was drawn to the materialistic greed that sprang out of it."

Word of Enron's accounting irregularities leaked out slowly during the fall, depressing the company's already-dropping stock price. Its businesses destroyed and its reputation in tatters, Enron finally filed for Chapter 11 bankruptcy protection Dec. 2.

Watkins wrote her memo on the heels of the surprise resignation Aug. 14 of Enron Chief Executive Jeffrey K. Skilling. The corporate announcement of Skilling's departure ascribed it to "personal reasons."

But to Watkins and others inside the company, the move hinted at his deep unease at the accounting irregularities and presaged a difficult period of public scrutiny.

"I think he . . . looked down the road and knew this stuff was unfixable, and would rather abandon ship now than resign in shame in 2 years," she wrote to Lay. Moreover, she warned, "the probability of discovery significantly increased with Skillings's shocking departure. Too many people are looking for a smoking gun."

Many of Enron's financial maneuvers would not bear that scrutiny, she said, even though they had been formally approved byEnron's outside auditor, Andersen, formerly known as Arthur Andersen.

'We're Such a Crooked Company'

This particularly applied to deals Enron had made with LJM, a partnership that had been set up to trade with Enron and was managed by Enron Chief Financial Officer Andrew S. Fastow. The goal was to move debt and other liabilities off Enron's books, where they would have a negative effect on the company's financial picture, and park them with a putatively independent company. As long as these liabilities remained secret, Enron's reputation, and its stock price, remained buoyant.

The LJM deals inspired deep unease within Enron, Watkins related, quoting one colleague remarking: "I know it would be devastating to all of us but I wish we would get caught. We're such a crooked company."

Lay responded to Watkins' letter by meeting with her personally and persuading the Enron board to commission an internal review by Vinson & Elkins, one of Enron's Houston law firms.

Robert S. Bennett, Enron's Washington attorney, defended the company's response. The nine-page review of Watkins' concerns by Vinson & Elkins issued Oct. 15 shows "the good faith of Ken Lay and the company. . . . It shows that they meaningfully looked into this."

Bennett said the law firm interviewed Watkins but that it put "a lot of faith in Arthur Andersen."

Watkins, however, had specifically warned Lay against allowing Vinson & Elkins to conduct the investigation.

"Can't use V&E due to conflict," she wrote in her memo. "They provided some true sale opinions on some of the deals."

In other words, she argued that the firm would be ruling on the propriety of legal opinions it had itself issued.

Moreover, the law firm said in its report, written by Vinson partner Max Hendrick III and addressed to Enron General Counsel James V. Derrick Jr., that it was specifically instructed by Enron not to "second guess . . . the accounting advice and treatment" provided by Andersen. The report stated that Enron and Andersen representatives acknowledged that the accounting treatment of the suspect transactions "is creative and aggressive," but it did not conclude that it was "inappropriate from a technical standpoint."

Vinson & Elkins spokesman Joe Householder declined to discuss whether it was a conflict of interest for the firm to investigate Watkins' allegations.

"We are not in a position to talk about our engagements with Enron or any other client," he said.

As it happens, the firm overruled almost all of Watkins' substantive objections to the LJM transactions, although it did acknowledge some "awkwardness" arising from LJM's executives serving as Enron officers.

"Transactions were negotiated between Enron employees acting [for] Enron and other Enron employees acting for LJM," the law firm's report stated.

It also noted that within Enron there was widespread suspicion that the Enron employees representing LJM were enjoying special perquisites, including higher compensation. But it said the awkwardness would be eliminated in the future because LJM executives were leaving the Enron payroll and relocating their offices from its headquarters building.

Focus on the 'Raptor' Deals

The report did, however, provide indirect evidence of Enron's custom of minimizing the public disclosure of the nature of its financial maneuvers. Among other things, the company gave its outside lawyers little opportunity to examine closely the financial reports and other documents it was releasing for public consumption.

"Enron's practice is to provide its financial statements and disclosure materials to V&E with a relatively short time frame within which to respond with comments," the report stated.

In her memo, Watkins focused most heavily on several transactions between Enron and LJM known as the Raptor deals. The term referred to a special business entity that Enron had established to hold several investments that were expensive and of possibly marginal value, including ownership in a broadband communications company called Rhythms NetConnections and other technology and energy companies.

To cover the LJM-Raptor acquisition of the investments, Enron pledged shares of its own stock and that of some of its subsidiaries. But it also engaged in a series of complicated derivatives deals aimed at hedging the possibility that the value of Rhythms and the other assets would fall.

In 2000, Watkins noted, Enron went as far as to record more than $500 million in revenue from those derivatives deals. That, she said, presented numerous problems.

For one thing, Enron had not received the $500 million from LJM. Rather, the payment was conditioned on the value of the underlying investments remaining high; if the investments deteriorated, there was an increasing chance that Enron would never receive the money.

Further, it was likely that a truly independent company would not have paid anywhere near $500 million for the investments at issue--meaning that the deal was not legitimately an arm's-length sale.

Vinson & Elkins acknowledged this, noting in its report that LJM "permitted Enron to close transactions that otherwise could not have been accomplished."

In fact, as the value of the investments dropped, Enron was obligated to make up the difference by paying LJM more of its own stock.

Throughout 2001 the underlying investments did fall in value--and so did the value of Enron stock. That meant the company had to contribute vastly more shares to LJM than it ever anticipated. That was a contingency that was never fully disclosed to the public or Enron's shareholders, who stood to lose value in their own shares as more were pledged to LJM.

"It sure looks to the layman on the street that we are hiding losses in a related company and will compensate that company with Enron stock in the future," Watkins wrote.

Not until Nov. 8 did Enron fully disclose the nature of the Raptor deals--as part of its public announcement that the improper accounting of those transactions and others resulted in its overstating its earnings by $586 million over a nearly five-year period.

The announcement all but destroyed any chance that the company would be able to survive in its existing form.

Addiction to Accounting Tricks

Enron critic Mark Roberts, president of Off Wall Street Consulting Group, a Cambridge, Mass.-based stock research firm, said the Watkins memo adds to the evidence of Enron's addiction to illegitimate accounting tricks.

The Raptor deals were derivative transactions "with recourse," meaning deals in which the counter-party would be compensated for any losses, he noted in an interview.

"If the buyer doesn't have risk, the risk stays with Enron and has to be reflected on their balance sheet," said Roberts, whose firm sold Enron shares "short," a bet that they would fall, as early as last May.

Andersen Knew of Enron Risks Last February

■Probe: E-mail memo indicates executives in Chicago were aware of questionable issues. Also, the energy trader's board fires the auditor

By RICHARD SIMON and JERRY HIRSCH, Times Staff Writers

WASHINGTON -- Top executives at the Chicago headquarters of accounting firm Andersen discussed Enron's financial problems in February, but two months later its auditors gave the energy giant's books a clean bill of health, documents show.

The Feb. 5 meeting represents the earliest known date that senior Andersen officers--including its head of U.S. operations--knew about such issues as Enron's aggressive deal making, internal conflicts of interest and huge compensation packages for its senior management.

The meeting, held by telephone between Chicago and the Houston branch office that handled the Enron account, was detailed in an e-mail the next day. Andersen has contended that it was unaware of serious problems until August.

The e-mail memo reported that Andersen considered dropping Enron as a client, though it noted that the accounting firm could earn fees from Enron reaching $100 million a year.

"Ultimately, the conclusion was reached to retain Enron as a client [because] it appeared that we had the appropriate people and processes in place to serve Enron and manage our engagement risks," the e-mail read.

Andersen auditors in April signed off on Enron's financial statement for fiscal years 2000 and 1999, saying it "fairly represented" the company's condition.

It wasn't until Oct. 16 that Enron reported serious financial losses, although Andersen had the ability to rescind its approval of the company's financial statements at any time.

The new disclosures came as Enron's board fired Andersen as its auditor and Congress pushed ahead with its probe of the Houston-based company's collapse.

After obtaining the e-mail, congressional investigators on Thursday sent a letter to Andersen's chief executive, Joseph F. Berardino, seeking more information about the senior-level meeting.

The e-mail from Andersen executive Michael E. Jones to partner David B. Duncan related to a meeting the day before in which Andersen executives discussed some of the Enron accounting methods that have become the subject of criminal and congressional probes.

The e-mail raised concerns about conflicts of interest from a partnership managed by Enron's then-chief financial officer, Andrew S. Fastow, which investigators say was used to hide the energy company's debts. The meeting is significant because until its disclosure, attention has focused on Andersen's Houston office, where Duncan--chief auditor on the Enron account--was fired and seven others disciplined Tuesday because of the destruction of Enron-related records.

An Andersen spokesman, Patrick Dorton, said Thursday that "nothing in the meeting or the memo indicated that any illegal actions or improper accounting was suspected." He said it was not until Enron Vice President Sherron S. Watkins alerted auditors in August that the accounting firm "became aware that individuals within Enron believed that there may have been accounting improprieties."

But Ken Johnson, a spokesman for the House Energy and Commerce Committee, one of several congressional panels investigating Enron's collapse, said: "From our perspective, the memo made it clear that some Andersen officials were clearly aware of the risks of having Enron as a client but decided in the end the company was too much of a cash cow to cut loose."

The e-mail also said that during the conference call, executives discussed how Enron "often is creating industries and markets and transactions for which there are no specific rules." The memo said Fastow faced potential conflicts from his role both as an officer of the energy trader and a paid manager of the LJM partnership that was doing business with the company.

The question was left unanswered as to whether the Securities and Exchange Commission would view Fastow and LJM as an affiliate of Enron, which would have obligated Andersen to wrap the financial results of LJM into the figures for the larger company.

Once disclosed, the debt and losses at LJM and other partnerships led to a rapid decline in Enron's credit rating, pushing the company to file for bankruptcy protection Dec. 2.

A spokesman for Fastow declined to comment on the House investigation but added that Enron's former chief financial officer did not hide his involvement with off-balance-sheet partnerships.

"The Enron board of directors had full knowledge and understanding of Mr. Fastow's potential conflicts and gave its full approval," said his spokesman, Gordon Andrew. "Business law does not say that conflicts of interest per se are illegal in any regard as long as they are disclosed and approved."

When Enron issued its annual report in April, Andersen asserted that in its opinion the financial statements "present fairly . . . the financial position of Enron Corp. and subsidiaries as of Dec. 31, 2000, and 1999 . . . in conformity with accounting principles generally accepted in the United States."

The e-mail was raised by congressional investigators during a private meeting with fired auditor Duncan this week. Duncan, one of 14 Andersen employees on the Feb. 5 conference call, was fired for allegedly ordering the destruction of documents. He has denied any wrongdoing.

Andersen spokeswoman Anne Groves said the e-mail summary of the teleconference confirmed that senior management had discussed various issues surrounding the Enron audit. The people at "this meeting represented every aspect of our work at the company at a senior level," she said. "They were the right people to make the decisions that were made."

One of the meeting's participants was Steve Samek, who at the time was the firm's managing partner for its U.S. operations. Another was Robert Kutsenda, who was censured by the SEC in June and barred from working on the audit of a publicly traded company for a year because of his involvement in Andersen's audit of Waste Management Inc.

Andersen paid a $7-million fine in that audit to settle fraud charges--the largest civil penalty against a Big Five accounting firm.

Although he was not one of the lead partners in the audit, Kutsenda, Andersen's central-region audit practice director, consulted on Waste Management and engaged "in highly unreasonable conduct that resulted in a violation of applicable professional standards," according to SEC records.

Kutsenda has since retired from the firm, Groves said, and Samek is a partner in a different position.

In a statement, Andersen said the meeting described in the e-mail was routine, of a sort typically done to assess the firm's work on all large engagements. It defended the memo's use of such terms as "intelligent gambling," saying that was a reference to the "mark-to-market" method of accounting, which "is based on sophisticated models using assumptions about events likely to occur in the future."

Attendance of a large number of partners, including senior staff, is typical at these meetings, according to Andersen.

"Client acceptance is a continuous process. Before we sign off on an audit, or decide to continue as the auditor for a company, we consider all major events to confirm or modify our conclusions about our audit opinion and our decision to continue as the company's auditor," the firm's statement said.

"The identification of a particular issue during one of these meetings does not indicate that the firm has reached any conclusions about the appropriateness of an accounting treatment or judgment. It simply indicates that such issues need to be addressed in the audit, if the firm continues the relationship."

As for its firing by Enron, Andersen said: "As a matter of fact, our relationship with Enron ended when the company's business failed and it went into bankruptcy."

Enron CEO Kenneth L. Lay said Thursday in a statement that although the company has been conducting its own investigation and had been "willing to give Andersen the benefit of the doubt . . . we can't afford to wait any longer in light of recent events, including the reported destruction of documents by Andersen personnel and the disciplinary actions taken against several of Andersen's partners working in its Houston office."

Congressional investigators, meanwhile, also made available an Aug. 21 internal Andersen memo detailing a call from Watkins to an Andersen employee raising concerns about accounting methods that "did not tell the 'whole story.' " She raised similar concerns to Lay the same month.

Rep. W.J. "Billy" Tauzin (R-La.), chairman of the House Commerce and Energy Committee, said his panel's investigation is in its early stages. But he said the fallout from the Enron debacle could fill his committee's agenda for much of this year and that an overhaul of the nation's accounting standards is almost certainly in order.

Tauzin suggested in an interview that it may be time to consider prohibiting accounting firms to perform audit and business consulting work for the same client. Critics have long complained of the inherent conflicts in such lucrative arrangements, but Congress has resisted such changes.

"We may all need to reconsider our position on that," Tauzin said.

Tauzin expects his committee to hold hearings this month on the document destruction conducted by Andersen's Houston office after it learned of the SEC probe.

At the White House, spokesman Ari Fleischer spent a second day on the defensive, declaring that the administration had not tailored its energy proposal to benefit Enron. He called a report by Rep. Henry A. Waxman (D-Los Angeles) that contends that the administration's proposal benefits Enron "a partisan waste of taxpayer money."

The White House finds itself in a bind--to some extent one of its own making. After first disclosing Enron's efforts to reach out to two Cabinet members--Treasury Secretary Paul O'Neill and Commerce Secretary Don Evans--it has adopted a defensive posture. Officials have declined to say to what extent they are trying to determine what contacts Enron and its representatives had with the administration and what steps, if any, administration officials took as a result.

The refusal to make such disclosures has become entangled with the long-running refusal to turn over to congressional investigators requested information about the workings of Vice President Dick Cheney's energy task force.

Fleischer said Thursday that in refusing to hand over documents about the task force, the White House was honoring "a very important principle," holding that it is "the right of the people in our country to petition their government, to talk to their government. . . ..

"The suggestion that any contact with the government is somehow sinister and, therefore, it should be examined . . . is a principle that has big implications beyond what we're talking about today," he said.

Andersen Fires Executive Who Oversaw Enron Audit

■Accounting: Firm puts three partners on leave and relieves four others of management duties.
By JERRY HIRSCH, Times Staff Writer

The Andersen accounting firm said Tuesday that it fired the executive in charge of auditing Enron Corp., saying partner David B. Duncan organized an effort to destroy thousands of documents after learning of an inquiry by the Securities and Exchange Commission.

Andersen also placed three other partners responsible for the Enron engagement on administrative leave and took away management responsibilities from the four partners who ran the Houston office where the Andersen audit was conducted.

"Based on our actions today, it should be perfectly clear that Andersen will not tolerate unethical behavior, gross errors in judgment or willful violation of our policies," Joseph F. Berardino, Andersen's managing partner and chief executive, said in a statement.

Sullivan & Cromwell, the New York law firm representing Duncan, issued a statement saying he did nothing wrong and is cooperating with investigators. A spokesman said Duncan was following the instructions of an Andersen attorney.

Duncan did not return a phone call to his home.

An Andersen official said the firm learned in the first week of January that documents had been destroyed. Its assertion that Duncan systematically destroyed documents after learning that the SEC was looking into the Enron audit is yet another devastating blow to Andersen, said Lynn Turner, the SEC's former chief accountant.

"It is about as close to an admission of guilt that you can get without actually saying it," Turner said.

Typically, accounting firms facing probes and litigation place the partner who headed the problem audit "on ice" while the matter sorts out, according to accounting experts. They don't allow the individual to do more audits, but they don't fire the person, because they want the partner to testify on the firm's behalf.

"It is almost unheard of for a partner to get fired during one of these investigations, and so early in it," said Turner, who heads the Center for Quality Financial Reporting at Colorado State University.

Andersen collected $25 million for the Enron audit, one of the largest audit fees in corporate America. Microsoft, by comparison, paid less than $5 million in audit fees last year.

Turner predicted the firing would help congressional investigators, who plan to meet with Duncan in Washington today. "Frankly, now that he's been fired, he may have a little more motivation to cooperate with us," said Ken Johnson, a spokesman for the House Energy and Commerce Committee.

Investigators are reviewing six boxes of Duncan's personal files, which they hope to use to reconstruct some of the destroyed records. Johnson said that Duncan may have "crucial information" relevant to the probe--"and apparently he's prepared to share it with us."

Each successive revelation about how it handled the Enron audit--starting last year when Andersen reissued the energy company's financial reports, slicing nearly $600 million off its profit statements over a four-year period--has been increasingly damaging for the firm, said Howard Schilit of the Center for Financial Research and Analysis in Rockville, Md.

The firm's integrity has been challenged, employee recruiting and retention efforts have been damaged and Andersen faces the prospect of huge financial penalties and judgments stemming from numerous federal probes and Enron shareholder lawsuits.

Duncan, 42, is a former treasurer of the Alpha Tau Omega fraternity at Texas A&M who serves on the advisory board of the business school's accounting department.

Duncan also is a member of the politically powerful board of the American Council for Capital Formation, a Washington-based organization that lobbies for business-friendly tax and environmental policies.

Also on the board are Enron Chairman Kenneth L. Lay and an array of Washington blue-chippers from both parties, including former Secretary of State George P. Shultz, former Treasury Secretary Lloyd Bentsen, former House Ways and Means Committee Chairman Bill Archer and former ambassador and Democratic Party chief Robert S. Strauss.

Andersen claimed that an internal investigation found that Duncan organized an "expedited effort to destroy documents" in the Houston office and called a meeting with staff members Oct. 23 to get the task started.

What is especially damaging, according to accounting experts, is that Andersen asserts Duncan started shredding papers and deleting electronic files after learning that Enron had received a request for information from the SEC about its financial accounting and reporting. Such an action could be grounds for obstruction of justice charges.

"This effort was undertaken without any consultation with others in the firm and at a time when the engagement team should have had serious questions about their actions," Andersen said in its statement.

"The activity appears to have ended shortly after the lead partner's assistant sent an e-mail to other secretaries on Nov. 9--the day after Andersen received a subpoena from the SEC--telling them to 'stop the shredding,' " Andersen said.

Andersen rejected the claims of Duncan's attorney that he was following orders. The firm said an Oct. 12 e-mail to the Houston office from Nancy Temble, an in-house attorney, was a routine reminder for the Enron team to follow the firm's documentation and retention policy and did not authorize the destruction of documents.

The e-mail to Andersen partner Michael C. Odom said: "Mike--It might be useful to consider reminding the engagement team of our documentation and retention policy. It will be helpful to make sure that we have complied with the policy. Let me know if you have any questions."

Schilit said Andersen's actions and statements over the last several days represent the seeds of what might turn into the accounting firm's defense.

"Andersen may be in a damage-control mode where they stress that their internal policies were violated and that this guy is a scoundrel," Schilit said.

But others said Andersen is correct to sever ties with people it believed violated its policies and to disclose what happened.

"This is a sad situation all the way around, but Andersen is taking the right steps to restore its reputation and working through the details as you would expect," said Randolph Beatty, dean of USC's Leventhal School of Accounting.

Ira Solomon, head of the accounting department at the University of Illinois, noted that although Andersen has had a troubled audit, the firm is acting responsibly and that "You can't characterize Andersen as a corrupt organization."

The accounting firm said it has recovered some documents from electronic backup files and is working to retrieve more. Andersen also said it does not believe that any crucial "work papers" were destroyed. Such papers typically detail the rationale for accounting decisions made during an audit.

Andersen said its internal probe is continuing and that the individuals already named and other staff members could face additional sanction.

The partners who were put on leave were Thomas H. Bauer, Debra A. Cash and Roger D. Willard. The Houston-based partners being relieved of management responsibilities were D. Stephen Goddard Jr., Michael M. Lowther, Gary B. Goolsby and Odom.

A Duncan associate, Jerry Strawser, dean of the school of business at Texas A&M, said Duncan was well-regarded in Texas accounting circles, and he reserved judgment on Andersen's allegations.

"Any time our department of accounting wanted to do a project or needed ideas of how to structure courses or programs, he would be on the short list of who to call," Strawser said.

Duncan also was instrumental in recruiting students for Andersen and in using his Andersen contacts to raise funds for the school, Strawser said.

Times staff writers Thomas S. Mulligan in New York and Richard Simon in Washington and researcher Penny Love contributed to this report.

Monday January 28, 2002

Weekly Electricity Status Report

1. Northwest Power Pool Status (WA, OR, ID, MT, WY, UT, No. NV, BC, AB)

- Power Pool peak load (Friday, 1/19): MW 47,727
- Reserve margins were within comfortable ranges for Northwest Power Pool utilities.

2. Mid-Columbia Trading Hub Electricity Prices

- Weekly Range at Mid-C: $18.5-19 per MWh
- "Normal" price range, before 5/00 $20-$40 per MWh

3. California Electricity Situation

- CA ISO Alert Status
  - There were no warning notices this week.
  - Most recent rotating blackouts: Tuesday, May 8

- News Headlines from California
  - Enron chief Ken Lay ousted (LA Times, 1/24)
  - Enron's run tripped by arrogance, greed. (LA Times, 1/27)

- Status of Emergency Orders
  - Federal court has ruled that generators can't be forced to sell emergency power to the state in suit brought by Reliant. (Updated April 9)

4. River and Snowpack Information (updated 1/28 & 1/14)

- Observed December stream flows: 71.7% of average at The Dalles
- Snowpack: Forecast 102% of normal (Natl. River Forecast Center)

5. Energy Conservation Achievement (updated 1/14/2002)

- **Major electric utilities:** 3-12% below normal; Tacoma 12% total savings since Jan 1. (Updated June 5)
- **State Agencies:** From January 2001 – November 2001 the monthly average savings has been -10.4% for electricity and –15.5% for natural gas. (Updated January 14, 2002)

6. Fish/Reservoir Impacts (updated 12/10)

- Operations to protect Columbia River chum salmon spawning below Bonneville Dam began on Nov. 20. The target for chum flows below Bonneville Dam is a tailwater elevation of 11.0 feet, which takes tidal and tributary influences into account.

7. Power Exchanged with California (updated 1/14/2002)

- Week of Dec 6-12
  - Power sent to CA ISO: 333 MWh
  - Power returned from CA ISO: 500 MWh
  - Amount CA ISO owes BPA: 0 MWh

CA ISO has now returned all power owed to BPA as a result of exchanges entered into during the winter and spring of 2001. No further exchanges are anticipated at this time.

Enron's Chairman Kenneth Lay Ousted

By NANCY RIVERA BROOKS, DAVID STREITFELD and LEE ROMNEY, Times Staff Writers

HOUSTON -- Kenneth L. Lay was ousted Wednesday as chairman and chief executive of Enron Corp., the company that he spent 15 years building into the world's largest energy trader only to watch it crumble amid allegations of financial trickery.

Enron said it is searching for a turnaround specialist to save what is left of what was once the nation's seventh-largest company but which now holds the dubious distinction of having filed the largest-ever bankruptcy petition.

Lay said he resigned after talks with Enron's board and the 15-member creditors' committee selected as part of Enron's bankruptcy proceedings.

The bank-dominated creditors' committee had been pushing for Lay's departure so that new managers could oversee Enron's attempt to reorganize and repay the money it owes, sources familiar with the situation said. The decision was reached Wednesday morning during a board meeting with Enron's far-flung directors checking in by telephone.

"The creditors just want a green-eyeshade guy who gets their money back for them," one source said.

Lay will remain a director of the company.

"I want to see Enron survive, and for that to happen we need someone at the helm who can focus 100% of his efforts on reorganizing the company and preserving value for our creditors and hard-working employees," Lay said in a statement. "Unfortunately, with the multiple inquiries and investigations that currently require much of my time, it is becoming increasingly difficult to concentrate fully on what is most important to Enron's stakeholders."

Houston-based Enron filed for bankruptcy protection Dec. 2, listing more than $50 billion in assets and more than $31 billion in debts.

Lay, 59, has been named in more than 50 lawsuits, and his company's disintegration is being investigated by several congressional committees, the Justice Department and the Securities and Exchange Commission.

That Lay was tossed out comes as less of a surprise than the leisurely time it took to do it, Enron watchers said.

Lay held on as a series of damaging financial disclosures about murky off-balance-sheet partnerships and overstated earnings hammered Enron's stock price, wiping out billions of dollars of investor holdings and the retirement savings of Enron employees.

Lay survived a failed last-ditch merger attempt with cross-town rival Dynegy Inc., which fled claiming that it hadn't realized the depths of Enron's troubles. He lasted as Enron's debt plunged to junk status and lenders turned their backs, causing an all but fatal cash crunch that pushed Enron into bankruptcy.

But the heat rose in the last few weeks with increasingly damaging revelations, including:

• Lay and other Enron executives contacted Bush administration officials late last year seeking help for the flailing company.

• Lay was warned in August by a company vice president of a possible corporate implosion if details of the off-balance-sheet transactions became known.

• Lay was touting the stock to employees in September, shortly before Enron announced its worst quarter in corporate history.

• Enron employees and those of its auditor, Andersen, shredded documents after the launch of a federal inquiry.

"For whatever value remains in Enron to be realized, Lay's resignation was necessary," said Edward Muller, an investor in energy ventures and former president of Irvine-based Edison Mission Energy, who said Lay "stood in the way of decisions being made to realize value for creditors and move the organization forward."

Prudential Securities analyst Carol Coale said the decision comes too late.

"When Wall Street was calling for Ken Lay's head, it was early in the game," Coale said. "Wall Street thought that would be the responsible thing for the board to do. But at this point, it makes him look guilty."

"I don't think the market's going to react favorably to that," she said, noting that the company's stock took a plunge when CEO Jeffrey Skilling resigned abruptly in August.

Enron, which little more than a year ago traded at nearly $90 a share on the New York Stock Exchange, closed Wednesday at 34 cents in over-the-counter trading, down 9.5 cents. Lay's resignation was announced after markets closed.

The reaction from Enron employees, current and former, was bitter.

"It was bound to happen," said Maritta Mullet, a former 10-year employee who lost nearly half a million dollars in retirement benefits. "I'm surprised he's been able to face up to all these people and stay in there so long.

"I feel terribly betrayed by him," added Mullet, who said Lay was "blushing over with how good everything looked" in a September online chat with employees.

Rumors had swirled in recent days that a new management team was about to be named, perhaps to be led by Jeffrey McMahon, Enron executive vice president and chief financial officer. McMahon was named to those posts in late October, replacing Andrew S. Fastow, who helped engineer the off-balance-sheet partnerships that greased Enron's slide into bankruptcy.

With Lay's departure, McMahon would be the only remaining member of Enron's three-person office of the chairman. The third member, Enron President Lawrence Greg Whalley, is leaving Enron to run the trading operation that Enron is selling to UBS Warburg in a noncash profit-sharing deal.

Lay merged two natural gas companies and built Enron, which went on to extraordinary success in the 1990s. As success grew, Lay lobbied successfully for a new U.S. energy regimen, one that moved away from regulated distribution of basic electricity and fuel to a constantly trading market, in which his company above all could make trades and profit on price spreads.

But Lay's pride in his own accomplishments harbored secrets. His company was not able to buy and sell so much electricity and other commodities without employing hidden accounts to hold borrowings it was not reporting to its shareholders or the Securities and Exchange Commission.

The construction of Enron ultimately rested on more than 3,000 hidden partnerships. And in the recession year 2001, it came apart with awful speed, exposed as a company that over-reported profit by hundreds of millions to maintain the high stock price that supported millions of dollars in stock options and stock gains for Lay and his fellow Enron executives.

Enron officials have touted the pending sale of the company's trading operation to UBS as the beginning of a new future. The deal was blessed by the U.S. Bankruptcy Court on Friday, and UBS already has extended job offers to 640 Enron employees.

Enron spokesman Mark Palmer said he did not know what kind of retirement package Lay was being given, but noted that any agreement would have to be approved by the Bankruptcy Court.

Lay earned hundreds of millions of dollars at Enron, primarily through lucrative stock options in recent years.

In 2000, Lay exercised options worth $123.4 million, according to Enron filings with the Securities and Exchange Commission. His base salary that year was $1.3 million, and he was given a $7-million bonus.

Lay, despite reaping more than $200 million from stock options and other Enron compensation in the last three years, also had a credit line of as much as $7.5 million from Enron that he used repeatedly last year, his lawyer Earl Silbert disclosed to the media.

Lay provided the company with Enron stock each time he repaid the loan, then would draw on the credit line again, sometimes because he needed additional cash to cover other personal investments that had gone sour, Silbert said.

Much of the activity occurred last summer, shortly before Lay urged Enron employees in September to keep buying Enron stock because it was an "incredibly cheap stock." Only weeks later, Enron disclosed the worst financial results in its history.

At the end of 2000, Lay held 5.1 million options worth $257.5 million and an additional 1.5 million options worth more than $100 million that were scheduled to vest in coming years, according to the SEC documents.

However, the plunge in Enron's stock price probably renders any unexercised options worthless.

Lay received a $3.6-million bonus in early January 2001. The company has not released figures relating to his 2001 salary and option grants.

Enron's Run Tripped by Arrogance, Greed

Profile: A lack of discipline and a drive to bend rules were key factors in the meltdown.

By DAVID STREITFELD and LEE ROMNEY, Times Staff Writers

HOUSTON -- Two years ago, the executive committee of Enron Corp. convened to select a new slogan for the company. Enron was on fire, entering new markets and starting new businesses on almost a daily basis. The old slogan, "The world's leading energy company," was too limiting.

The committee's top choice for a replacement: World's coolest company.

"It's a vision of innovation; it's a vision of creativity," Enron President Jeffrey K. Skilling said at the time. To underline the point, then-Chairman Kenneth L. Lay suggested wrapping the headquarters building in a pair of giant sunglasses.

The name Enron now conjures up images of monstrous greed and massive fraud, shredded documents and empty 401(k) plans, but for quite a while it was considered one of the country's leading corporations. Analysts marveled over it, Fortune magazine voted it "most innovative" six years in a row and people were eager to work there.

It wasn't mass delusion. For much of its 16 years, Enron did indeed appear innovative, creative and cool, although the executive committee never made the new slogan official. It was the kind of place where the normal workplace rules were suspended for what seemed the best reason: to free people to achieve excellence.

Much of the transformation was the work of Skilling, who arrived at Enron in 1990 from the consulting group McKinsey & Co. and rose to become chief executive for six months before resigning last August. During Skilling's first week at Enron, his secretary brought him a stack of expense accounts to review.

"You've got to be kidding me," Skilling recalled in a 2000 interview for an academic study. "Here the world's just fallen apart around us--deregulation, new customers, new products. And I'm going to sit here line-item by line-item and go through an expense statement?"

Henceforth, he decreed, expense reports would routinely be approved without review.

As Skilling ascended, he overhauled the company culture. He set employees loose, encouraging them to push the edge of every rule, even without their supervisors' knowledge. He instituted a company-wide performance review system designed to weed out the weak. He rewarded fast results with big money. And he said that not only would Enron pattern itself after General Electric, the most sustained success in corporate America, but it would also surpass it.

In the hothouse atmosphere of the late '90s, all of these ideas seemed reasonable, even commonplace. The stock market was soaring. People confused getting rich with being smart. The dot-coms, then riding high, looked like they would kill off the stodgy old industrial companies. It seemed like the boom times would never end.

By the time they did early last year, Enron had become less a company than a collection of mercenaries, according to current and former employees. Secret partnerships were set up that critics say violated the most basic conflict-of-interest rules.

Company earnings and revenue were inflated or illusory. Hardly anything was real, unless it was the tens of millions of dollars that top executives were making from selling stock as fast as they could.

Enron was not only one of the biggest corporate collapses in American history, it was also one of the fastest; what appeared a viable if overextended company in September was bankrupt in December. Every day brings fresh allegations of chicanery and manipulation by both Enron and its auditor, Andersen. Ten congressional committees are investigating, as is the Securities and Exchange Commission and the Justice Department.

On Friday morning, former Enron Vice Chairman J. Clifford Baxter was found dead in his Mercedes-Benz. The death was ruled a suicide Saturday by the Harris County, Texas, medical examiner's office. Friends said he was despondent over having been unable to put a stop to Enron's highly questionable accounting methods.

"Enron prospered by challenging the limits of accepted behavior. The vast bulk were in ways that were socially, legally and politically acceptable," said Robert F. Bruner, a University of Virginia graduate business professor who cowrote a multimedia study of Enron that was conducted in 2000 and 2001.

"But Enron lost discipline over its aggression," Bruner said. "The biggest reason for Enron's fall is its absence of humility."

Bruner's study is the source of this story's quotes from former Enron executives Lay, Skilling and Chief Financial Officer Andrew S. Fastow, who are now declining media interviews.

Louise Kitchen was a young British trader spearheading Enron's entry into Europe's energy markets. She wasn't a top executive and hadn't even turned 30. But Kitchen cooked up a plan for the company's online trading operation.

Online trading was seen as Enron's future. Under Skilling's guidance, the company was moving hard assets like power plants off its balance sheet into complex partnerships. The goal was an "asset light" company that would make its money brokering contracts to provide power and other commodities.

She rallied a team of supporters and they designed the entire business out of the company's London offices, much of it on nights and weekends. Skilling was on record as being opposed to automated trading systems, so Kitchen, who bootlegged $30 million in hardware from other Enron divisions and drew 380 people into the project, didn't tell him.

The head of the London office finally broached the subject of online trading, Skilling later recounted to his interviewers. Skilling says he rolled his eyes but agreed that such a system might just work.

"That's good," the London executive said, "because we're rolling it out next week."

It was an immediate triumph, with 65,000 natural gas, electricity, petrochemical and other transactions in the first four months. Kitchen soared too. Just last fall, she was ranked 17 on Fortune's list of the 50 most powerful women in business.

This was the era when the dot-com philosophy of "first-mover advantage" held sway: Whoever entered a new market first would dominate it.

One young Enron executive had a notion about trading high-speed computer bandwidth. Skilling says he set him loose, not even telling his supervisor. "His boss would say, 'No, just keep doing what you're doing,' " Skilling said. Nothing was off-limits. The company got into trading weather derivatives (to hedge against swings in temperature that may affect a business) and launched plans to do the same with advertising space. And its creativity quickly extended to finance.

"I don't think Enron had any fear," said Richard Kottke, a former engineer and weather trader with the company. "There wasn't anything they wouldn't try to make money at. Any reasonable person would look at that mentality and say, 'I see how that would lead a person to do something in accounting to push the envelope.' "

It was, said another ex-employee, all part of being "creative."

"If you asked your managers about the law, they said it could be written better but that wasn't our job," said this man, who worked in the research unit analyzing prospective deals. "Our job was to take advantage of the law to make as much money as we can."

Current and former employees, some of whom wanted to talk anonymously to protect their job or just keep out of the media firestorm, describe a place where ideas were implemented fast, but if they didn't yield immediate results, the project would end up on the scrap heap just as quickly.

The new businesses weren't always worth much in the present. But with so-called mark-to-market accounting, future values of long-term contracts were counted immediately. Still, the dollars were phantom dollars, which drove the need for yet more deals, insiders say.

Take the broadband unit. Enron cut a deal with Blockbuster to deliver movies to viewers' homes through telephone lines. The joint venture was a legitimate, although ultimately unsuccessful, idea: The market, and the technology, just weren't there yet.

Nonetheless, the phantom profits went onto the books, said one former vice president.

This kind of accounting was one of several factors that led to the company's decline.

By last winter, the company was in constant flux.

"The company was notorious for reorganizing every six months," said Ron Lumbra, Houston executive director of the corporate search firm Russell Reynolds Associates.

"We needed to bring in people who could handle their boss being transferred in their third week on the job and their business being restructured in their sixth week."

Luring the best and brightest to Enron became a Skilling fixation. But that wasn't enough. Employees had to constantly improve, and who better to judge their work than their peers?

Skilling took the performance review process he learned at the consulting group McKinsey to Enron.

Every six months the frenzy would repeat itself. Employees and managers would scramble to find reviewers among supervisors, subordinates and peers. Self-evaluations were projected onto screens and debated.

It took three weeks to chew over an employee's record and rate it against everyone else who held a similar position. Workers were ranked on a scale of one to five, with the number determining their bonuses, and their fates.

"Those who don't really meet the standards get cycled out of the company pretty quickly, which is probably good for them and good for the company," Lay told the University of Virginia researchers in April 2000.

Individual excellence was in. Teamwork was out.

"People became proprietary about their deals," said one Enron veteran. "Why should I help Johnny if I'm rated against Johnny?"

As the New Economy soured, there was much less success to go around. That only increased the competition. "As the company internally realized it was entering troubled times, rank-and-yank turned into a more political and crony-based system," said Bruner, the Virginia professor.

Some managers lied, altering records on employees they wanted gone, said Charles Turcich, an information technology contract worker who spent 18 months at Enron.

"Managers would change time from sick time to just 'absent' to make [workers] look bad. They'd keep spreadsheets of attendance and go back and change them," Turcich said.

"Enron was a really unpleasant place to work," agreed one trader who is nevertheless still there. "It was ridiculously competitive, even vicious. . . . I locked my desk every night so my colleagues wouldn't steal my work."

Officially, everyone played well together. Enron's stated values were dubbed RICE: Respect, Integrity, Communication, Excellence. Lay himself selected them, employees were reminded. The values were engraved on knickknacks, from Lucite squares to plaques and rocks, and given to employees as inspirational gifts.

But in practice, some say, everyone was judged on "origination"--or how much business you were bringing to the company. "I went to a lot of evaluation meetings," said one junior executive, "and I never heard anyone evaluated by any standard but origination."

The company grew because money mattered and it mattered more and more as the company grew, current and former employees say. Everyone knew what the stock was doing at every minute. New employees not only hoped to make a bundle but demanded it.

"You get the deal done, you get paid," said executive recruiter Lumbra, who was told by one senior executive that Enron was "the best meritocracy in business."

Those who made money exulted in it. One trader remembers one of his colleagues standing on his desk after the stock had had a particularly good day. "I am so rich!" he shouted. One executive, Lou Pai, sold stock worth $353 million.

Excess is rarely frowned on in Texas, but Enron began to press even the state's tolerance. You could identify Enron employees, people said, by the way they swaggered.

"They were totally cocky. They were arrogant. They thought everything they did was right," said one local attorney who had friends at the company. "They thought they were reinventing the . . . wheel."

By late September, after Skilling resigned and it was apparent the company was spiraling downward, Lay made a last-ditch cheerleading effort. His "Lay It on the Line" in-house survey generated 4,000 responses from employees about the company in three days. On Oct. 2, he e-mailed the results to them, one of whom gave The Times a copy.

More than 1 out of 3 said they weren't committed to staying at Enron. Other signs of trouble: 42% said the company was more "self-serving" than it had been a year earlier, while 39% said it had grown more "arrogant." And 37% said the company was less "trustworthy."

Lay tried to right the ship. The performance review system would be modified, he promised. A new employee relations office would be established to field criticism. And efforts to stress "integrity and respect" would be redoubled.

"Enron's values will have more importance in each employee's evaluation and feedback," Lay wrote.

"We are all responsible for how we treat our co-workers and customers."

But the words were just words. Enron's slide was unchecked.

After a failed merger attempt with a smaller competitor, Dynegy, led Enron into its December bankruptcy, Prudential Securities' Houston office questioned whether anyone could have married such an abrasive bride.

"Enron's arrogance and mercenary culture was deep-rooted in the company," wrote analyst Carol Coale, "and we doubted that even a fraternal management team like that of Dynegy's would have been able to reshape the mind-set of Enron's management and employees."

Still, traces of the infatuation ingrained for so long in the loyal work force remain. One young man, who said he lost more than $50,000 in his savings plan and a small fortune in stock options and bonus money, was still optimistic that the company would survive.

"I believe in the integrity of the management," he said. "This job could be fun again."